No. 80-1709

SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1980

RICHARD MADSEN and
NANCY MADSEN, his
wife, for themselves
and all others
similarly situated,
Respondents,

vs.

PRUDENTIAL FEDERAL SAVINGS & LOAN
ASSOCIATION, for itself and all
others similarly situated,
Petitioner,

UTAH BANKERS ASSOCIATION,
Intervenor,

PRUDENTIAL FEDERAL SAVINGS &
LOAN ASSOCIATION,
Petitioner,

vs.

RICHARD MADSEN and NANCY MADSEN,
Respondents.

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

REPLY TO PETITION FOR WRIT OF CERTIORARI

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STATEMENT OF THE CASE

Madsen borrowed money from Prudential to purchase a home. The loan was made pursuant to a Trust Deed agreement. The Trust Deed required Madsen to make monthly "budget payments."1/

The "budget payments" are really advance payments for taxes and insurance. Prudential accumulates the "budget payments" until year end. At that time, the taxes and insurance are paid on behalf of Madsen.

Madsen sued Prudential in state court. The suit was brought as a class action. Madsen claimed that Prudential earned a profit by using the "budget payments" before the taxes and insurance were due. The theory of the lawsuit was breach of contract or unjust enrichment.

Some three months after the lawsuit was filed, the Federal Home Loan Bank Board promulgated a new regulation known as 12 C.F.R. § 545.6-11(c).2/

Prudential did not remove the case to the federal court based on the new regulation. Instead, Prudential mov-

---

1/For relevant text of Trust Deed contract, see Petition for Writ of Certiorari, p. 6.

2/For a complete text of the regulation, see Petition for Writ of Certiorari, p. 4-5.

ed for summary judgment in the state trial court. In support of that motion, Prudential argued in detail that the new federal regulation had preempted the field. For a complete text of the argument see Appendix A. The state trial court granted summary judgment.

Madsen appealed to the Utah Supreme Court. In the Utah Supreme Court, Prudential repeated the substance of its federal arguments. For a text of those federal arguments, see Appendix B.

The Utah Supreme Court reversed. Specifically, the Utah Supreme Court ruled that:

> The essential elements of a pledge are contained in the agreement, viz., the existence of a debt or obligation, a transfer of property to the pledgee, to be held as security and, if necessary, to be used to assure performance of the obligation.
>
> * * *
>
> . . . If from the use of the property pledged profits are derived, the pledgee must in the absence of a special agreement to the contrary account therefor to the pledgor, and apply the net proceeds of such use to the extinction of the debt. So if any profits accrue from property held as collateral, such profits, while they may be collected and retained by the pledgee, must be credited to the pledgor, or applied to the sum due from him, as

> where dividends accrue on pledged stock, or interest is collected on a security held as collateral.
>
> Madsen v. Prudential, 558 P.2d 1337, 1339-1340 (Ut. 1977).

After remand from the Utah Supreme Court, Madsen amended the complaint to newly allege a class of defendant lending institutions.

After Prudential had lost its case in the Utah Supreme Court, it removed the case to the federal court. Prudential then filed a declaratory judgment case in the federal court seeking relief from the state court action. A copy of the removal petition is attached as Appendix C.

Madsen moved to remand the removal case. Madsen also moved to dismiss the declaratory judgment case.

The federal district court denied those motions and proceeded to reconsider the federal preemption issue which had already been decided by the Utah Supreme Court. Based on federal preemption, the federal district court granted summary judgment in favor of Prudential. See Appendix B to Petition for Writ of Certiorari.

Madsen appealed to the Tenth Circuit Court of Appeals. The circuit court reversed holding that the federal district court had no jurisdiction at all.

POINT ONE

THE PETITION FOR CERTIORARI IS FATALLY DEFECTIVE BECAUSE IT IS NEARLY FOUR YEARS TOO LATE

In 1977, the Utah Supreme Court decided this case. The opinion was silent on federal preemption. However, the issue had been argued. (See Statement of Facts above.)

The fact that the Utah Supreme Court reversed summary judgment can only mean that Madsen has a valid claim at common law notwithstanding 12 C.F.R. § 545.6-11 (c). Stated in other words, the Utah Supreme Court necessarily rejected Prudential's federal preemption theory.

It makes no difference that the opinion of the Utah Supreme Court does not specifically discuss federal questions. Grubb v. Public Utilities Commision of Ohio, 281 U.S. 470, 50 S.Ct. 374 (1930); Kaufman v. Somers Bd. of Education, 368 F.Supp. 28 (E.C. Conn. 1973); Fowler v. Wolff, 479 F.2d 338 (8th Cir. 1973).

The Utah Supreme Court remanded for consideration of other issues. However, the decision on federal preemption was final. See, e.g., Cox Broadcasting Corp. v. Cohn, 420 U.S. 469, 95 S.Ct. 1029, 43 L.Ed.2d 328 (1975);

New York v. Cathedral Academy, 434 U.S. 125, 98 S.Ct. 340, 54 L.Ed.2d 346 (1977).

Prudential had ninety days from the date of the Utah Supreme Court decision to petition for certiorari on its federal preemption theory. 28 U.S.C. § 2101(c). But Prudential did not do so. Instead, it went to the federal district court.

However, the federal district court has no appellate jurisdiction over state supreme courts. Rooker v. Fidelity Trust Co., 263 U.S. 413, 416 (1923). Prudential should have petitioned for certiorari to this Court in 1977. It did not do so. It should not be allowed to come here four years later in the same case and on the same grounds.

POINT TWO

A REVERSAL OF THE CIRCUIT COURT WOULD OVERWORK FEDERAL COURTS

Prudential argues that prememption automatically creates removal jurisdiction. In response the circuit court ruled that:

> However, even if federal preemption were established, it would not confer jurisdiction when it is raised by the defendant to defeat a common-law contract claim brought in state court.
> Appendix D-12.

That is the only sensible solution. Any other rule would overwork federal courts. The problem is that preemption is easy to claim but difficult to prove. As Justice Frankfurter has stated, "Metaphor--'occupied the field' has at times done service for close analysis." Bethlehem Steel Co. v. New York Labor Rel. Bd., 330 U.S. 767, 782 (1947).

If Prudential prevails, here is what will happen. Everyone who wants to get into federal court will simply claim preemption. Then the federal court will be required to analyze whether preemption has been proven before the court even knows if it has jurisdiction. Federal courts just do not have time to go through that process in every removal case.

This case is an excellent example. Prudential claims the field has been preempted. However, that claim rests on very weak grounds. No court has ever held that 12 C.F.R. § 545.6-11(c) has preempted the field. Three cases have held that there is no preemption.3/

Why should Prudential be able to invoke removal jurisdiction by a weak claim that something has been preempted? To permit entry to the federal courts on that basis would open the floodgates.

3/ Derenco, Inc. v. Benj. Franklin Fed. Sav. & Loan Assn., 577 P.2d 477, 487 (Ore. 1978) (no preemption); Buchanan v. Century Fed. Sav. & Loan Assn., 393 A.2d704, 713 n. 19 (Pa. Super. 1978) (no preemption - dictum); Johsnon v. First Fed. Sav. & Loan Assn. of Detroit, 418 F. Supp. 1106, 1109 (E.D.Mich. 1976) (no preemption - dictum). See also Osborne, Nelson & Whitman, Real Estate Finance Law, (West Publishing Co. 1979)pp. 693-695.

POINT THREE

THE ISSUE WHICH PRUDENTIAL WANTS TO HAVE DECIDED MAY BE MOOT

Prudential wants this Court to rule that preemption will create removal jurisdiction. However, that issue may be moot.

Madsen argued in the district court and the circuit court that the removal petition was filed too late. The complaint was filed on March 3, 1975. The removal petition was filed on October 27, 1977.4/ Prudential argued that the removal was timely. See Petition for Writ of Certiorari, p. 12, n.8. However, that is an unusually complex issue. We are attaching a letter from the trial court judge requesting additional briefing on that specific issue. See Appendix E. A reading of that letter will show how complex that issue is.

4/ The removal statute provides that the defendant must file the removal petition:

> . . . within 30 days after receipt by the defendant . . . of a copy of the initial pleading setting forth the claim for relief upon which such action or proceeding is based . . . (or) if the case stated by the initial pleading is not removable, a petition for removal may be filed within thirty days after receipt by the defendant . . . of a copy of an amended pleading from which it may first be ascertained that the case is one which is or has become removable.
>
> 28 U.S.C. § 1446(b).

Here is the point. It would be a great waste of resources for this Court to rule on the preemption issue only to find that the removal petition was too late anyway. That issue was mooted by the decision of the circuit court. However, it will not be moot if certiorari is granted.

POINT FOUR

PRUDENTIAL'S THEORY OF PREEMPTION ARISES ONLY RARELY IN THE CIRCUIT COURTS

Prudential cites four circuit court cases in support of its theory on preemption. (See Petition for Writ of Certiorari, pp. 34-42.) The opinion of the Tenth Circuit cites two circuit court cases which contradict Prudential's theory. (Appendix D-22.)

By our count that makes six circuit cases which have confronted this issue in the last century. Thus, this is not a matter which arises frequently.

Nor is there any great potential for harm. Prudential never loses its federal claims. Even when the case is remanded, Prudential may still litigate its federal claims in state court. Missouri Pac. Ry. Co. v. Fitzgerald, 160 U.S. 556, 583, 16 S.Ct. 389, 396 (1896).

POINT FIVE

THERE IS NO CONFLICT IN THE CIRCUITS ON THE ISSUE OF DECLARATORY JUDGMENT JURISDICTION

Prudential contends that the circuit erred in denying jurisdiction over the declaratory judgment action. Specifically, Prudential contends that two other circuits have conflicting rules. 5/

However, there is no conflict in the law. Those cases simply present different fact situations. The opinion in this case states: "This case is not like Conference . . . /or/ Greenwald . . . or other cited by Prudential . . . where state regulations directly conflict with federal regulations . . . . No such conflict exists here." Appendix D-21-22.

5/ First Federal Savings & Loan Assn. of Boston v. Greenwald, 591 F.2d 417 (1st Cir. 1979) and Conference of Federal Savings and Loan Assns. v. Stein, 604 F.2d 1256 (9th Cir. 1979), Aff'd. 445 U.S. 921 (1980).

POINT SIX

THIS CASE IS NOT AN APPROPRIATE OPPORTUNITY FOR THIS COURT TO FASHION FEDERAL COMMON LAW

The federal regulation under consideration states: "Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts . . . ." 12 C.F.R. § 545.6-11(c). However, Madsen does have a contract. His claim is based on that contract. Prudential seeks to have federal common law interpret the Madsen contract.

This Court has stated in United States v. Yazell, 86 S.Ct. 500, 382 U.S. 341, 15 L.Ed.2d 404 (1966):

> None of the cases in which this Court has devised and applied a federal principle of law superseding state law involved an issue arising from an individually negotiated contract . . . . None of these cases overrode state law in the peculiarly state province of family or family-propety arrangements.
> 382 U.S. at 353.

This Court has also stated:

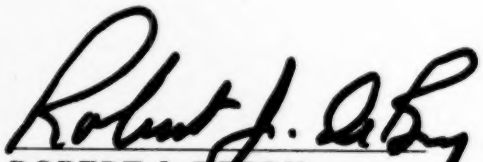
> The instances where we have created federal common law are few and restricted.
> Wheeldin v. Wheeldin, 83 S.Ct. 1441, 1445; 373 U.S. 647, 651, 10 L.Ed.2d 605 (1963).

State courts have, from the time of the founding father, interpreted private contracts. There is no reason to change that principle now.

CONCLUSION

The Petition for Writ of Certiorari should be denied.

DATED this 30th day of April, 1981.



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Attorney for Respondents
Richard and Nancy Madsen

CERTIFICATE OF SERVICE

I, Sharon Gustafson, certify that I am a clerk in the office of Robert J. DeBry, attorney of record for Richard Madsen and Nancy Madsen, the respondents herein, and that on April 30, 1981, pursuant to Rule 33, Rules of the Supreme Court, I served three copies of the foregoing Reply to Petition for Writ of Certiorari on each of the parties required to be served herein, as follows:

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Honorable Aldon J. Anderson
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Sharon Gustafson

A new regulation was adopted by the Federal Home Loan Bank Board on June 16, 1975. /12 C.F.R. § 545.6-11(c) is omitted./ This Regulation is applicable to all loans made by defendant (Home Owners' Loan Act, 12 U.S.C. § 1461, et seq.). It in essence says defendant "shall have no obligation" to pay interest on escrows (the reserve accounts) "except as provided by contract", unless a state statute specifically requires state associations to pay such. We have no Utah statutes that specifcally require payment of interest or earnings on the reserve accounts. The amount federal associations shall pay, when required, is limited to the rate paid on regular (savings) accounts. This Federal Regulation "preempts the field" as to conflicting state action or regulation of Federal savings and loan associations; Myers v. Beverly Hills Fed. S. & L. Ass'n. (1974, C.A. 9th), 499 F.2d 1145; Kupiec v. Republic Fed. S. & L. Ass'n (C.A. 7th 1975), 512 F.2d 147, 150; Murphy v. Colonial Fed. S. & L. Ass'n (2nd Cir. 1967), 388 F.2d 609 ("The exclusivity of federal laws means that when state courts 'deal with the internal affairs of federal savings and loan associations, . . . they are nonetheless applying federal law '. . . an issue which requires "fleshing out of the F.H.L.B.B. regulations, is one of Federal law'.") "The Home Owners' Loan Act, supra, contemplates a uniform set of policies for federally chartered associations which does not vary with quirks of local law," Rettig v. Arlington Heights Federal Savings & Loan Ass'n 405 F. Supp. 819 (D.C. Ill. 7/2/75, Civil No. 74-C-3151); Murphy v. Colonial Fed. S. & L. Ass'n, supra. When applying Federal common law, the Court should give great weight to F.H.L.B.B. regulations. Udall v. Tallman, 380 U.S. 1, 16-17 (1965). After the appellate courts remanded for trial in Carpenter, Abrams and Buchanan, the F.H.L.B.B. acted on the subject of compensation to borrowers on reserve accounts, specifically preempting that field. The net effect of the new Regulation is to provide that in Utah, where state statutes do not impose any requirement, the only "obligation" that can be enforced against or imposed upon federal savings and loan associations to pay any compensation on reserve accounts is that "obligation provided by contract." Here, plaintiffs do not even claim compensation by contract, but base their case on "unjust enrichment"or "trust" theories.

There are plenty of policy reasons why federal savings and loan associations, so heavily regulated on a federal basis,

should not be required in the future to pay interest or earnings on the reserve accounts. Whatever view one may take as to "fairness" it is clear that the F.H.L.B.B. has left, and the courts should leave, this decision to the legislatures of the various states. The Courts should do likewise and indeed, they must do likewise, in view of the new Regulation which preempts the field. The legislatures can act in futuro, balancing the fact that legislation requiring compensation will put the lenders in that state at a competitive disadvantage, since they must either charge higher rates to compensate or eliminate the reserve requirement and, thus, have less secure loans to sell in the national secondary market against any conceived social good arising from the legislation. But it is a legislative problem, not a legal problem, capable of ex post facto determination by courts which must construe contracts.

Defendants' Supplement to Memorandum in Opposition to Plaintiffs' Motion for Summary Judgment, Third Judicial District Court, Civil No. 226073, November 6, 1975.

A new regulation was promulgated by the Federal Home Loan Bank Board on June 16, 1975 to prescribe the circumstances under which federal savings and loan associations, such as defendant, may pay interest on escrows. It provides (12 C.F.R., § 545.6-11(c)): *(Regulation is omitted.)* Utah statutes are silent as to any requirement that interest be paid on escrows; indeed the silence in the authorization statutes (§§7-7-5(e) (3) and 7-12-47 (1) (2), U.C.A. 1953), is deafening.

Brief of Respondent at 4-5, Supreme Court of Utah, Case No. 14530.

Thus, great deference should be given to the federal regulations and the cases which intepret them in determining whether plaintiffs have a claim against defendant. Udall v. Tallman, 380 U.S. 1, 16-17 (1965). Those regulations all imply that plaintiffs' claim is unfounded.

Id. at 12.

There are plenty of policy reasons why federal savings and loan associations, so heavily regulated on a federal basis, should not be required to pay interest or earnings on the reserve accounts on mortgages they make in the future. Whatever view one may take as to "fairness", it is clear that the F.H.L.B.B. has left, and the courts should leave, this decision to the legislatures of the various states. The Court should do likewise in view of the new federal regulation (12 C.F.R., § 545.6-11(c)), stating when interest may be paid on these escrows. The legislature can act in futuro, balancing on one hand the problem that legislation requiring compensation on reserves will put the lenders in the state at a competitive disadvantage, since they must either charge higher rates to compensate or eliminate the reserve requirements and, thus, have less secure loans to sell in the national secondary market. Against this must be balanced any conceived social good arising from the legislation. But this is a legislative problem, not a legal problem, capable of ex post facto determination by courts which must consture existing contracts, not future policy.

Id. at 16-17.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

---oooOooo---

RICHARD MADSEN and NANCY A. MADSEN, for themselves and all other similarly situated,	)	
Plaintiff,	)	PETITION FOR REMOVAL
vs.	)	
PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all other similarly situated, Defendants.	)	

---oooOooo---

TO THE JUDGES OF THE UNITED STATES DISTRICT COURT FOR THE CENTRAL DISTRICT OF UTAH:

This Petition of Prudential Federal Savings & Loan Association, on behalf of itself and all other similarly situated, respectfully shows:

1. On February 27, 1975, plaintiffs Madsen commenced an action in the Third Judicial District Court in and for Salt Lake County, Utah, Civil No. 226073, against defendant Prudential Federal Savings & Loan Association as sole defendant. In that original complaint, plaintiffs alleged

defendant lent money upon trust deeds requiring plaintiffs, and all other borrowers similarly situated, to pay monthly in advance one-twelfth of estimated real property taxes and insurance premiums on the mortgaged property as a reserve for payment of such taxes and premiums when due, and that defendant (1) breached its contract by not paying interest thereon, or (2) was unjustly enriched through use of the reserve funds, and prayed for such interest or the amount by which defendant was unjustly enriched.

2. On October 12, 1977, that State Court entered its Order granting plaintiffs' Motion to Amend Complaint, and defendant was served with plaintiffs' Second Amended Complaint. By the Second Amended Complaint, plaintiffs allege defendant is a member and proper class representative of a class of all mortgage banking institutions domiciled in Utah, and that defendant and such institutions have loaned money upon trust deeds requiring their borrowers to pay monthly, in advance, one-twelfth of estimated real estate taxes and insurance premiums on the mortgaged property as a reserve for payment of such taxes and premiums when due, and newly alleged that defendant and each member of the defendant class should account for and pay to the borrowers

the profits earned or to be earned from use of said funds. The causes of action in the original complaint for (1) breach of contract and (2) for unjust enrichment were omitted from the Second Amended Complaint.

3. This Petition for Removal is filed by defendant in its alleged representative capacity on behalf of all members of said alleged defendant class within 30 days after receipt of a copy of the initial pleading setting forth the claim for relief against such members, and by defendant for itself within 30 days after the filing of an entirely new and different cause of action.

4. A copy of the process, pleadings and orders served upon petitioner is filed herewith, certified by the Clerk of the District Court of Salt Lake County, Utah.

5. The cause of action described in the Second Amended Complaint may be removed to this Court under 28 U.S.C.A. § 1441, is a civil action of which this Court has original jurisdiction under 28 U.S.C.A § 1331 or § 1337 in that the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution and laws of the United States, or arises under Acts of Congress regulating commerce. Some members of

the alleged defendant class are federally chartered savings and loan associations or commercial banks, and defendant is alleged to be and is a federally chartered savings and loan association. The relief sought by the Second Amended Complaint arises under and is determined and controlled by federal law, including but not limited to: United States Constitution, Article VI, Clause 2; 12 U.S.C.A. § 1461, et seq.; 12 U.S.C.A. § 1464(a); 12 C.F.R. § 545.6-11(c); 12 U.S.C.A. § 1337; 12 U.S.C.A. § 371; Reg. Q 12 C.F.R. § 217; and the federal body of law applicable thereto.

6. Petitioner files herewith a bond with good and sufficient surety that it will pay all costs and disbursements incurred by plaintiffs by reason of this removal should be determined that this action is not removable or is improperly removed.

WHEREFORE, petitioner prays that Civil Action 226073, now pending in the District Court of Salt Lake County, Utah be removed to this Court.

DATED this 26th day of October, 1977.

Respectfully submitted,

MOYLE & DRAPER

By _____

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600 Deseret Plaza
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UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Richard MADSEN and Nancy Madsen, his wife, for themselves and all others similarly situated, Plaintiffs-Appellants,

v.

PRUDENTIAL FEDERAL SAVINGS & LOAN ASSOCIATION, for itself and all others similarly situated, Defendant-Appellee,

Utah Bankers Association,
Intervenor-Appellee.

Richard MADSEN and Nancy Madsen, for themselves and all others similarly situated, Petitioners,

v.

Honorable Aldon J. ANDERSON, Judge of the United States District Court for the District of Utah, Central Division, Respondent.

Nos. 79-1362, 79-1535

Decided December 3, 1980

Rehearing Denied January 23, 1981

Before LOGAN, PECK* and SEYMOUR, Circuit Judges.

SEYMOUR, Circuit Judge.

The Madsens, plaintiffs-appellants, borrowed money from Prudential Federal Savings

*Of the United States Court of Appeals for the Sixth Circuit sitting by designation.

& Loan Association (Prudential) to purchase a home in 1964. Pursuant to this loan, the Madsens signed a trust deed[1] requiring them to make "budget payments" of one-twelfth of the annual estimated taxes and insurance along with their monthly payments of principal and interest. Under the agreement, these budget payments were pledged as additional security for repayment of the loan.

---

[1]The trust deed provides in pertinent part:

> "In addition to the monthly payments as provided in said note, the TRUSTOR agrees to pay to the BENEFICIARY, upon the same day each month, budget payments estimated to equal one-twelfth of the annual taxes and insurance premiums; said budget payments to be adjusted from time to time as required, and said budget payments are hereby pledged to the BENEFICIARY as additional security for the full performance of this deed of trust and the note secured hereby. The budget payments so accumulated may be withdrawn by the BENEFICIARY for the payment of taxes or insurance premiums due on the premises. The BENEFICIARY may at any time, without notice, apply said budget payments to the payment of sums due under the terms of this deed of trust and the note secured hereby or either of them. TRUSTOR'S failure to pay said budget payments shall constitute a default under this trust."

App., vol. I, at 5.

The funds were accumulated in a reserve account and used annually for the payment of taxes and insurance.

On March 3, 1975, the Madsens[2] filed a class action[3] in Utah state court seeking to recover interest realized from Prudential's use of the escrowed funds, based on claims of breach of contract and unjust enrichment. The state trial court granted Prudential's motion for summary judgment. In January 1977, the Utah Supreme Court reversed the summary judgment and remanded for further proceedings. It held that the trust deed contained the essential elements of a pledge, and that under Utah common law a pledgee must account to the pledgor for profits resulting from the use of the pledged property. In October

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[2]The original complaint named Richard Madsen only as plaintiff. An amended complaint was filed April 10, 1975, joining his wife Nancy.

[3]Numerous issues regarding the classes named in these proceedings have been raised on appeal. They are not relevant to our disposition of this case and are not addressed in our opinion.

1977, the Madsens amended their complaint to ask for an accounting and recovery of the profits earned by Prudential on the escrowed amounts. This amended complaint added a defendant class of lenders with similar escrow arrangements.

Meanwhile in April 1977, Prudential filed a separate action for declaratory relief in federal court, asserting that under 12 C.F.R. §545.6-11(c)[4] (hereinafter

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[4]12 C.F.R. §545.6-11(c) provides:

> "A Federal association which makes a loan on or after June 16, 1975, on the security of a single-family dwelling occupied or to be occupied by the borrower (except such a loan for which a bona fide commitment was made before that date) shall pay interest on any escrow account maintained in connection with such a loan (1) if there is in effect a specific statutory provision or provisions of the State in which such dwelling is located by or under which the State-chartered savings and loan associations, mutual savings banks and similar institutions are generally required to pay interest on such escrow accounts, and (2) at not less than the rate required to be paid by such State-chartered institutions but not to exceed the rate being paid by the Federal association on its regular accounts (as defined by Section 526.1 of this chapter). Except as provided by contract, a Federal association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph." (Emphasis added).

referred to as section 545.6-11(c)), it is not required to pay interest or account to the Madsens on the escrowed funds. The complaint based jurisdiction on 28 U.S.C. § 1337[5] and sought a declaration of the rights and obligations of the parties to the trust deed. When the Madsens amended their state complaint, Prudential promptly filed a removal petition, alleging that the relief requested arises under and is controlled by federal law. The Utah Bankers Association, a trade association of commercial banks domiciled in Utah, intervened in the action, and the Federal Home Loan Bank Board filed an amicus curiae brief. The federal court denied the Madsens' motion to remand the case, consolidated the removed action and the declaratory judgment suit,

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[5]28 U.S.C. § 1337 provides:

> "The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies."

and granted summary judgment in favor of Prudential.

On appeal, the Madsens contend, inter alia, that the federal court lacks jurisdiction over either the removed case or the declaratory judgment action. We agree, and reverse with directions to remand the removed action to state court and to dismiss the declaratory action.

I.

Removal Jurisdiction

Prudential sought removal pursuant to 28 U.S.C. § 1441(b), which provides in pertinent part:

> "Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties."

Jurisdiction was claimed under 28 U.S.C.

§ 1331[6] and section 1337 because the cause of action allegedly arose under the laws of the United States and Acts of Congress regulating commerce.

The Madsens contend their claim in state court is founded upon contract rights and obligations created by state law. They assert that Prudential retains the Madsens' budget payments for up to a year before using the funds to pay the taxes and insurance, that Prudential invests the funds in the interim and receives a profit, and that the Madsens are entitled to be paid the profits earned on the pledged funds. The Madsens point out that no federal law or regulation was invoked, relied on, attacked,

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[6]28 U.S.C. §1331(a) provides in pertinent part:

> "The district courts shall have original jurisdiction of all civil actions wherein the matter in controversy exceeds the sum or value of $10,000, exclusive of interest and costs, and arises under the Constitution, laws or treaties of the United States."

We note that the same standards apply to whether the issue "arises under" federal law in both this section and section 1337.

or cited in their complaint. Consequently, they say, their claim did not arise under federal law.

Prudential and Intervenor argue, on the other hand, that the trust agreement between Prudential and the Madsens contains no express language requiring the payment of interest on the escrowed funds, and that the federal regulation does not contemplate interest payments under such circumstances. They say that interpretation of the agreement arises under federal law because Prudential is a regulated federal savings and loan association and Congress has preempted the area.

The conditions under which a suit may be said to "arise under" the laws of the United States were definitively set out in Gully v. First National Bank, 299 U.S. 109, 57 S.Ct. 96, 81 L.Ed. 70 (1936). There the Court stated that the required federal right or immunity must be an essential element of the plaintiff's cause of action, and that

the federal controversy must be "disclosed upon the face of the complaint, unaided by the answer or by the petition for removal." Id. at 113, 57 S.Ct. at 98. It is beyond argument that a defense predicated upon federal law is not enough by itself to confer federal jurisdiction, even though the defense is certain to arise. Pan American Petroleum Corp. v. Superior Court, 366 U.S. 656, 663, 81 S.Ct. 1303, 1307, 6 L.Ed.2d 584 (1961); Seneca Nursing Home v. Kansas State Board of Social Welfare, 490 F.2d 1324, 1328 (10th Cir. 1974), cert. denied, 419 U.S. 841, 95 S.Ct. 72, 42 L.Ed.2d 69 (1974); Warner Bros. Records, Inc. v. R. A. Ridges Distributing Co., 475 F.2d 262 (10th Cir. 1973).

In Mountain Fuel Supply Co. v. Johnson, 586 F.2d 1375, 1381 (10th Cir. 1978), cert. denied, 441 U.S. 952, 99 S.Ct. 2182, 60 L.Ed.2d 1058 (1979), we described the test for determining whether a complaint asserts,

on its face, a substantial federal question:

> "A case 'arises' under the laws of the United States if it clearly and substantially involves a dispute or controversy respecting the validity, construction or effect of such laws which is determinative of the resulting judgment. Shulthis v. McDougal, 225 U.S. 561, 32 S.Ct. 704, 56 L.Ed. 1205 (1912). Thus, if the action is not expressly authorized by federal law, does not require the construction of a federal statute and/or regulation and is not required by some distinctive policy of a federal statute to be determined by application of federal legal principles, it does not arise under the laws of the United States for federal question jurisdiction. Lindy v. Lynn, 501 F.2d 1367 (3rd Cir. 1974)."

No argument has been made on appeal that the Madsens' claim is expressly authorized by federal law. Consequently, federal removal jurisdiction is established in this case only if the Madsens' claim requires the construction of a federal regulation or the application of federal law.

The federal trial court based its finding of jurisdiction on North Davis Bank v. First National Bank, 457 F.2d 820 (10th Cir. 1972). We find that case distinguishable. There the central issue in the complaint

was whether the defendant's facility constituted a branch of a national bank. We noted that the Supreme Court in First National Bank v. Dickinson, 396 U.S. 122, 133, 90 S.Ct. 337, 343, 24 L.Ed.2d 312 (1969), held this determination to be a "threshold question of federal law." 457 F.2d at 822. Therefore we held: "[t]his is not a case in which a federal statute is indirectly or collaterally involved but it is one having its source in and arising under [the McFadden Act] 12 U.S.C. § 36(f)." Id. at 823.

Here the basic issue in the Madsens' complaint is whether the contract between the Madsens and Prudential requires the payment of profits or interest on escrowed funds. Although construction of the federal regulation cited by Prudential may be relevant to the defense Prudential asserts, i.e., that section 545.6-11(c) does not require payment of interest, the meaning of the regulation is absolutely irrelevant to the Madsens' theory of

recovery. Because the Madsens have predicated their suit upon rights created under state law, the fact that federal regulations may create a defense to recovery on such a claim is immaterial to a finding of federal question jurisdiction. See Phillips Petroleum Co. v. Texaco, 415 U.S. 125, 94 S.Ct. 1002, 39 L.Ed.2d 209 (1974); Pan American Petroleum, 366 U.S. at 662-64, 81 S.Ct. at 1307-1308.

Prudential and Intervenor contend that removal jurisdiction exists because federal law has preempted state law in the area of federal savings and loan regulation. The amicus curiae brief supports the argument that the field of regulatory control over federal associations has been preempted. However, even if federal preemption were established, it would not confer jurisdiction when it is raised by the defendant to defeat a common-law contract claim brought in state court. See Pan American Petroleum, 366 U.S. at 662-65, 81 S.Ct.

at 1307-1309; Washington v. American League of Professional Baseball Clubs, 460 F.2d 654, 660 (9th Cir. 1972), and cases cited therein. In Home Federal Savings & Loan Association v. Insurance Department, 571 F.2d 423 (8th Cir. 1978), the court dismissed the case for lack of subject matter jurisdiction despite a federal preemption argument:

> "[T]he Commissioner's proceeding against Home Federal was based solely upon alleged violations of Iowa's insurance law and raised no federal question. Home Federal's allegations of preemption and failure to engage in the 'business of insurance,' asserted in its federal petition, actually are in the nature of defenses to the Commissioner's charges. Hence they will not suffice for federal question jurisdiction here. The case is basically simply an alleged violation of state law. It is not a federal case and is not converted to one by Home Federal's defenses to the state's basic allegations."

Id. at 427. Prudential's claim of federal preemption is in the nature of a defense to the Madsens' cause of action and cannot be the basis of federal question jurisdiction on removal.

It is also argued that the Madsens' claim arises under the laws of the United States because the contract must be interpreted under federal common law rather than state law. This is so, Prudential urges, because the regulation addressing the payment of interest by federal savings and loan associations, section 545.6-11(c), states that "[e]xcept as provided by contract, a Federal Association shall have no obligation to pay interest on escrow accounts apart from the duties imposed by this paragraph." (Emphasis added). Prudential contends that the circumstances constituting a "contract" within the meaning of the federal regulation is a federal question.

It is true that the application of federal common law to a plaintiff's cause of action is sufficient to invoke federal jurisdiction and thus support removal. See Illinois v. Milwaukee, 406 U.S. 91, 100, 92 S.Ct. 1385, 1391, 31 L.Ed.2d 712 (1972).

However, federal common law is not automatically applied to resolve all disputes in a field subject to pervasive federal regulation. "In deciding whether rules of federal common law should be fashioned, normally the guiding principle is that a significant conflict between some federal policy or interest and the use of state law in the premises must first be specifically shown." Wallis v. Pan American Petroleum Corp., 384 U.S. 63, 68, 86 S.Ct. 1301, 1304, 16 L.Ed.2d 369 (1966). Here, it is vigorously argued that application of state law would create a significant conflict because federal policy requires uniform nationwide standards for the handling of escrow accounts by federal savings and loan associations. This argument founders on the very language of the regulation cited to support it. Section 545.6-11(c) provides that a federal savings and loan association shall pay interest on escrow accounts if a state statute requires such payments to

be made by state-chartered institutions, or if payments are required by contract. The regulation expressly anticipates that the obligation of a federal institution to pay interest on escrow accounts not only will vary from state to state, but from contract to contract. See Johnson v. First Federal Savings & Loan Association, 418 F.Supp. 1106, 1109 (E.D.Mich. 1976). Any argument that federal policy requires nationwide uniformity with regard to this issue is untenable.[7] See United States v. Yazell, 382 U.S. 341, 86 S.Ct. 500, 15 L.Ed.2d 404 (1966).

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[7]We note Intervenor's argument that this case arises under federal law because the mortgage form must be approved by the regulatory agency, see 24 C.F.R. §203.17, and because the mortgage must provide for monthly escrow payments for taxes and insurance, see 24 C.F.R. § 203.23(a). However, these regulations are silent on the issue of interest payments on escrow accounts, and therefore do not conflict with section 545.6-11(c), which allows interest to be required or prohibited by the individual contract terms. Accordingly, we reject the argument that the use of these forms mandates a uniform interpretation under federal law.

Contractual obligations are created by state law. See Gully, 299 U.S. at 114-15, 57 S.Ct. at 98-99. See also Pan American Petroleum v. Superior Court, 366 U.S. at 662-663, 81 S.Ct. at 1307-1308. "The interpretation and enforcement of contracts is [sic] traditionally within the province of state courts," Mariniello v. Shell Oil Co., 511 F.2d 853, 858 (3d Cir. 1975), and the general presumption is in favor of applying state law. Note: Federal Common Law, 82 Harv.L.Rev. 1512 (1969). Given the absence of a significant conflict between the federal policy expressed in section 545.6-11(c) and the use of state law, we hold that state law is applicable in determining whether Prudential contracted to pay interest on the Madsens' escrow account.

Since no federal controversy was disclosed on the face of the Madsens' state court complaint, as amended, removal was improper and the consolidated case must be remanded to state court.

II.

Declaratory Judgment Jurisdiction

The question remains whether the federal court has subject matter jurisdiction over Prudential's declaratory judgment action. The federal complaint alleges that Prudential is a federal savings and loan association regulated by the Federal Home Loan Bank Board, that it makes residential real estate loans insured and guaranteed by federal agencies, and that it is not permitted to pay interest or to otherwise account for profits realized on escrowed funds paid by mortgagors "except as provided by applicable federal regulations." App., vol. II, at 180. It points out that the Madsens have filed a class action in state court seeking interest on the escrowed funds under the contractual arrangements between Prudential and its borrowers, that "[a] proper resolution of said controversy requires a declaration of the respective rights and obligations of the parties to

said contractual arrangements," id. at 181, and that this determination presents a question under federal laws regulating commerce or under federal common law.[8]

As we have noted, the federal regulation that Prudential cites in its complaint provides that interest shall be paid on escrow accounts if a statute in the state whether the mortgaged property is located requires similar lending institutions to pay such interest. 12 C.F.R. 545.6-11(c), supra n. 4. The regulation also provides that a federal association has no other obligation to pay such interest "[e]xcept as provided by contract." Id. Consequently, the controversy underlying the federal declaratory judgment action is the same as in state court: whether Prudential is obligated by its contract with the Madsens to pay interest on the escrowed funds.

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[8]We have already concluded in part I, supra, that federal common law is not applicable to interpret the contract between Prudential and the Madsens.

This court has consistently adopted the rationale set out by the Supreme Court in Public Service Commission of Utah v. Wycoff Co., 344 U.S. 237, 248, 73 S.Ct. 236, 242-243, 97 L.Ed. 291 (1952):

> "Where the complaint in an action for declaratory judgment seeks in essence to assert a defense to an impending or threatened state court action, it is the character of the threatened action, and not of the defense, which will determine whether there is federal-question jurisdiction in the District Court. If the cause of action, which the declaratory defendant threatens to assert, does not itself involve a claim under federal law, it is doubtful if a federal court may entertain an action for a declaratory judgment establishing a defense to that claim. This is dubious even though the declaratory complaint sets forth a claim of federal right, if that right is in reality in the nature of a defense to a threatened cause of action. Federal courts will not seize litigations from state courts merely because one, normally a defendant, goes to federal court to begin his federal-law defense before the state court begins the case under state law. (citations omitted)."

(Emphasis added). In Monks v. Hetherington, 573 F.2d 1164, 1167 (10th Cir. 1978), we applied the traditional view "that a party cannot by artful pleading anticipate a defense based on federal law and thus bring

within federal jurisdiction an action that could not otherwise be heard in federal court." And in Chandler v. O'Bryan, 445 F.2d 1045, 1055-56 (10th Cir. 1971), we noted that this principle is particularly applicable where, as here, the state court action has been instituted and issues have been decided.

We held in part I, supra, that the federal preemption argument is defensive in nature. This is true whether the claim is made as the basis of removal or to support federal jurisdiction in a declaratory judgment action. See, e.g., Home Federal Savings & Loan Association v. Insurance Department, 571 F.2d 423 (8th Cir. 1978). This case is not like Conference of Federal Savings & Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979), aff'd mem., 445 U.S. 921, 100 S.Ct. 1304, 63 L.Ed.2d 754 (1980), First Federal Savings & Loan Association v. Greenwald, 591 F.2d 417 (1st Cir. 1979), or others cited by Prudential, Intervenor,

and amicus curiae, where state regulations directly conflict with federal regulations governing federal associations. No such conflict exists here.

The defensive nature of Prudential's claim is expressed throughout its complaint. It alleges that a state action has been brought seeking interest pursuant to the contractual arrangements between the parties, and that any order of the state court requiring Prudential to pay interest or otherwise account to the Madsens would be contrary to the federal regulations. If the Madsens had attempted to bring their action in federal court by anticipating or responding to Prudential's possible federal defense, the case would lack federal jurisdiction. See Phillips Petroleum, 415 U.S. at 128, 94 S.Ct. at 1004; Skelly Oil Co., 339 U.S. 667, at 672, 70 S.Ct. 876, 879, 94 L.Ed. 1194; Home Federal Savings & Loan Association, 571 F.2d at 426-27. It is irrelevant for purposes of jurisdiction that

"federal consent is the source of state authority." Gully, 299 U.S. at 116, 57 S.Ct. at 99; Oklahoma ex rel. Wilson v. Blankenship, 447 F.2d 687, 691 (10th Cir)., cert. denied, 405 U.S. 918, 92 S.Ct. 942, 30 L.Ed.2d 787 (1971).

Here as in Gully "[t]he most one can say is that a question of federal law is lurking in the background." 299 U.S. at 117, 57 S.Ct. at 99-100. Accordingly, we hold the court has no jurisdiction over the declaratory judgment complaint and the actions must be dismissed.

Reversed.

Chambers of
Aldon J. Anderson
United States District Judge
U. S. Courthouse

United States District Court
District of Utah
Salt Lake City, Utah 84101

October 10, 1978

TO COUNSEL OF RECORD:

C 77-0350 - Madsen v. Prudential Federal Savings and Loan

Gentlemen:

After reviewing the motions pending in this case, the court has determined that it is in need of further assistance of counsel in resolving important questions raised by those motions. The court is persuaded that federal question jurisdiction exists in this case by virtue of 12 CFR § 545.6-11(c). However, the court is uncertain whether the case was providently removed. Accordingly, the court hereby requests counsel to submit simultaneous memoranda on or before October 25, 1978, addressing the following issues:

1. Was this action as stated by the initial complaint removable:
   (a) By virtue of the fact that the language of Madsens' trust deed was mandated by federal law?
   (b) By virtue of any other then-existing basis for federal question jurisdiction?

2. Assuming that this action was not removable as stated by the initial complaint, did it become removable so as to trigger the running of the 30-day time limit for removal (by reason of promulgation of 12 CFR § 545.6-11(c) or for any other reason) prior to October 12, 1977, (operative date of Second Amended Complaint)?

3. Assuming that Prudential's petition for removal on its own behalf was not timely, was Prudential nonetheless entitled to remove on behalf of the alleged defendant class within 30 days after October 12, 1977?

4. Do the Madsens have standing to sue any mortgage lender other than Prudential:

(a) In their own right?

(b) As representatives of the previously certified class of Prudential's mortgagors (in the absence of information as to whether any members of that class also have outstanding mortgage loans owing to other potential defendants)?

(c) As representatives of the uncertified plaintiff class alleged in the Second Amended Complaint?

In connection with this issue, please comment upon the effect of Weiner v. Bank of King of Prussia, 358 F. Supp. 684 (E.D. Pa. 1973).

5. Assuming that the Madsens have standing to sue lenders other than Prudential, can the Rule 23(a) requirements of typicality and adequate representation with regard to plaintiff and defendant classes be met in this case in view of the fact that Madsens have no mortgage loan from any mortgage lender other than Prudential? In connection with this issue please comment upon the effect of La Mar v. H & B Novelty & Loan Co., 489 F.2d 461 (9th Cir. 1973) (holding that such requirements, as a matter of law, cannot be met).

6. Assuming that the requirements of standing and Rule 23(a) cannot, as a matter of law, be met as to the alleged defendant class:

(a) May the court properly consider the foregoing as a factor in determining whether Prudential is entitled to remove on behalf of the defendant class?

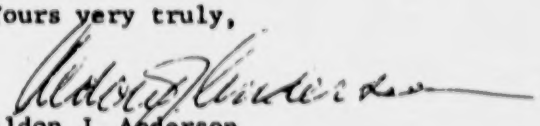
(b) If the court may consider such factors, would the absence of standing and/or nonconformity with Rule 23(a) preclude Prudential from removing on behalf of the defendant class?

The court urges counsel to formulate their responses with care in view of the fact that a position taken by a party with respect to questions 4 and 5 for purposes of determining removability may conflict with his position on those questions for purposes of class certification.

The court invites counsel to schedule oral argument before the court on these matters as soon as practicable after briefs are filed. Your assistance in this matter is appreciated.

The court also takes note of letters from counsel dated October 4 and 5, regarding Mr. DeBry's request for guidance as to whether he should respond to the Federal Home Loan Bank Board's amicus brief. The court declines to offer advice to counsel on that matter in view of the court's present request for assistance on other issues.

Yours very truly,



Aldon J. Anderson
United States District Judge

cc: Clerk of court